

Report
of the
Examination of
WEA Insurance Corporation
Madison, Wisconsin
As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Jorge Gomez, Commissioner

Wisconsin.gov

January 17, 2003

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Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, WI 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of
the affairs and financial condition of:

WEA INSURANCE CORPORATION
Madison, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1997 as of
December 31, 1996. The current examination covered the intervening period ending
December 31, 2001, and included a review of such 2002 transactions as deemed necessary to
complete the examination.

The examination consisted of a review of all major phases of the company's
operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance. They reviewed the adequacy of aggregate accident and health reserves, cash flow testing, due and uncollected premiums for health insurance, and in force testing. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

WEA Insurance Corporation (WEAIC) was organized in 1985, as the WEAIT Insurance Corporation. The present name was adopted in 1991. WEAIC is licensed as a stock life insurance company under ch. 611, Wis. Stat., and is controlled by its shareholder, WEA Insurance Trust (WEAIT). WEAIC is exempt from federal income tax as a voluntary employee benefit trust.

The company is licensed only in Wisconsin, and currently writes group medical, dental, long-term and short-term disability, and long-term care business to Wisconsin school districts whose teacher unions are affiliated with the National Education Association. This business results from collective bargaining between local teacher unions and school boards, where insurance benefits are usually a bargained benefit. The school district employer typically pays all or nearly all of the health insurance premiums for employees and their families, as an employee benefit. Some union contracts specify the insurance carrier and benefit level. The products are marketed through a staff of seven salaried field representatives.

The company has always offered a medical indemnity plan. In 1994, in response to the desire of some unions for a lower cost alternative, WEAIC introduced a point-of-service plan and a managed-cost plan. The number of subscribers by plan as of December 31, 2001, was as follows:

Plan	Subscribers		Dependents	Total
Group health plan (indemnity)	35,766	56.8%	57,607	93,373
Managed-cost plan	12,220	19.4%	17,263	29,483
Point-of-service plan	14,951	23.8%	22,964	37,915
Totals	62,937	100.0%	97,834	160,771

Following this paragraph is a summary of the premiums written by the company in 2001. The company does not cede or assume any reinsurance. Management periodically reviews the need for reinsurance and thus far has concluded that the benefits are not worth the cost. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Premiums Written	Percent of Total
Medical	\$364,433,392	70.1%
Prescription drug	97,611,530	18.8
Dental	41,604,291	8.0
Long-term disability	7,603,116	1.5
Short-term disability	1,132,642	0.2
Long-term care	<u>7,073,984</u>	<u>1.4</u>
Total	<u>\$519,458,955</u>	<u>100.0%</u>

The following table shows the number of school districts and Cooperative Educational Service Agencies (CESAs) participating in the various lines in recent years, of the 438 eligible districts and CESAs in Wisconsin:

Line of Business	Participating Districts		
	12/31/1997	12/31/2001	12/31/2002
Medical and drug	325	356	353
Dental	302	337	339
Long-term disability	318	331	333
Long-term care	35	87	86

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of eleven members. All directors are elected annually to serve a one-year term. Officers are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The boards of WEAIC and WEAIT are typically identical in size and membership; directors of WEAIT are elected for staggered three-year terms. The board members currently receive no compensation for serving on the board, but receive expense reimbursements for mileage and travel expenses to attend meetings.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Margaret Guertler Berlin, Wisconsin	Teacher	2003
Carol Holcomb Stevens Point, Wisconsin	Teacher	2003
Dennis Hortum Kiel, Wisconsin	Teacher	2003
Suzanne Kahl Verona, Wisconsin	Teacher	2003
Carol Kettner Rice Lake, Wisconsin	Teacher	2003
Peter Nagan Neenah, Wisconsin	Teacher	2003
William Roberts Sturgeon Bay, Wisconsin	Retired Teacher	2003
Marge Rosenthal Madison, Wisconsin	Retired Teacher	2003
Mary Theisen Franklin, Wisconsin	Retired Teacher	2003
Dennis Tietge Wausau, Wisconsin	Retired Teacher	2003
Janice Virlee Sturgeon Bay, Wisconsin	Retired Teacher	2003

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2001 Compensation*
Alan Jacobs	President	\$247,135
Paul Lefebvre	Treasurer	148,307
Michael Stoll	Vice-President and General Counsel	148,331
Peggy Smelser	Vice-President	150,455
Fred Evert	Vice-President	150,835
Alison Mares	Secretary	72,910
Faye Hampton	Assistant Secretary	70,200

* Amount shown is total compensation for all affiliates, and is paid by WEA Insurance Corporation. This amount is then allocated among affiliates.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The one committee at the time of the examination is listed below:

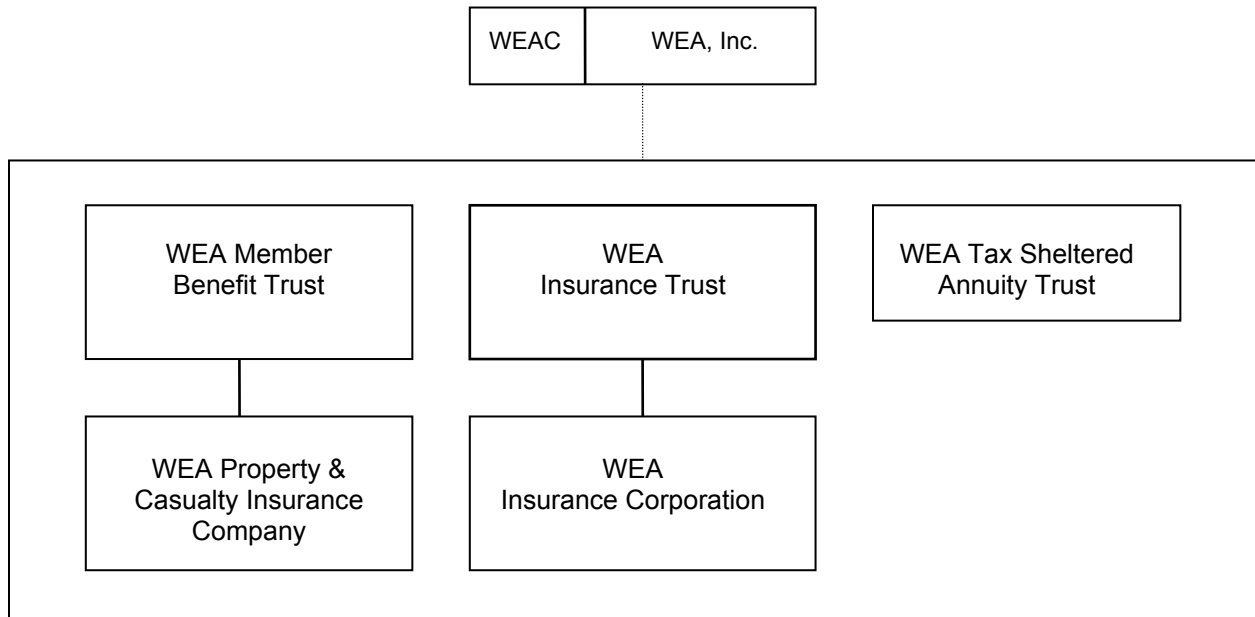
Executive Committee

Janice Virlee, Chair
William Roberts
Dennis Hortum
Mary Theisen

IV. AFFILIATED COMPANIES

WEAIC is a member of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of WEAIC follows the organizational chart.

**Organizational Chart
As of December 31, 2001**



Wisconsin Education Association Council (WEAC)

WEAC is an unincorporated labor organization whose members are local unions affiliated with the National Education Association. As such, WEAC is directed towards promoting the interests of its member school district employees.

Wisconsin Education Association, Inc. (WEA, Inc.)

This corporation is a Wisconsin not-for-profit corporation established by a special act of the Wisconsin legislature. Its principal functions are real estate ownership and trustee appointments.

WEA Insurance Trust (WEAIT)

WEAIT was established by WEA, Inc., in 1970 to provide various insurance benefits to qualified union member teachers and school district employees. WEAIT is exempt from federal income tax as a voluntary employee benefit trust.

WEAIT's health benefit plans including medical, dental, drug, disability, and long-term care, are underwritten exclusively by WEAI. Life insurance coverages are currently underwritten by Trustmark Insurance Company.

As of December 31, 2001, WEAIT's audited financial statement (consolidated with WEAI) reported total assets of \$342,764,174, liabilities of \$187,073,346, and net assets of \$155,690,828. Operations for 2001 produced a net loss of \$40,257,758.

WEA Member Benefit Trust (WMBT)

WMBT was established in 1972 to provide property and casualty insurance coverages to qualified union member teachers and school district employees. Before 1993, WMBT placed coverages with unaffiliated insurers, but now the business is underwritten by WMBT's subsidiary, WEA Property & Casualty Insurance Company. WMBT was formerly called the WEA Liability and Casualty Insurance Trust until the name was changed effective January 1, 1997.

As of December 31, 2001, the WMBT's audited financial statement (consolidated with WEAPC) reported assets of \$7,969,199, liabilities of \$4,715,833, and trust equity of \$3,253,366. Operations for 2001 produced net income of \$233,973.

WEA Property & Casualty Insurance Company (WEAPC)

WEAPC was established in 1993 to underwrite property and casualty insurance coverages to qualified union member teachers and school district employees. Products offered by the company include auto, homeowners, and inland marine insurance.

As of December 31, 2001, the WEAPC's audited financial statement reported assets of \$7,579,499, liabilities of \$4,611,468, and capital and surplus of \$2,968,031. Operations for 2001 produced net income of \$103,065.

WEAPC was examined concurrently with WEAIC. The results of that examination are included in a separate examination report.

WEA Tax Sheltered Annuity Trust (WEA TSAT)

WEA TSAT was established in 1978 to facilitate the investment of funds for qualified union member teachers and school district employees in tax-sheltered annuity contracts and mutual funds. WEA TSAT holds a group annuity contract issued by Connecticut General Life Insurance Company. WEA TSAT also serves as a registered broker/dealer allowing participants to invest in mutual funds.

As of December 31, 2001, the trust's audited financial statement reported assets of \$936,443,239, liabilities of \$934,884,487, and trust equity of \$1,558,752. Operations for 2001 produced a net loss of \$48,643.

Common Administration and Management

WEAC and WEA, Inc., are both managed by identical 40-person boards of Wisconsin school teacher trustees. WEAC provides all administrative support for WEA, Inc., within the terms of an administrative services agreement. WEA, Inc., under the advisement of WEAC, appoints the boards of trustees of all three trusts.

WEAIT and WEA TSAT are managed by identical 11-person boards of trustees. WMBT is currently managed by a 7-person board of trustees. One individual on WMBT's board of trustees also serves on the boards for WEAIT and WEA TSAT.

WEAIC's 11 directors and WEAPC's 7 directors are elected by, and identical to, their respective parents' boards of trustees. WEAIC operates independently employing about 200 people who manage and administer its health insurance products. WEAIC also provides all administrative support for the three trusts and some data processing and management services for WEAPC under the provisions of administrative services agreements.

V. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2001, annual statement to the Commissioner of Insurance. Also included in this section are schedules which reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

WEA Insurance Corporation
Assets
As of December 31, 2001

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$160,115,491	\$ 0	\$160,115,491
Stocks:			
Common stocks	82,999,451	0	82,999,451
Cash	(230,808)	0	(230,808)
Short-term investments	14,525,917	0	14,525,917
Receivable for securities	7,590,641	0	7,590,641
Electronic data processing equipment and software	2,942,053	988,013	1,954,040
Accident and health premiums due and unpaid	16,054,291	139,551	15,914,740
Investment income due and accrued	2,431,247	0	2,431,247
Other assets nonadmitted:			
Furniture and equipment	1,073,600	1,073,600	0
Cash advanced to or in hands of officers or agents	68,911	68,911	0
Loans on personal security, endorsed or not	105,422	105,422	0
Write-ins for other than invested assets:			
Prepaid Expense	312,676	312,676	0
Other Assets	<u>2,339,644</u>	<u>2,339,644</u>	<u>0</u>
Total Assets	<u>\$290,328,536</u>	<u>\$5,027,817</u>	<u>\$285,300,719</u>

WEA Insurance Corporation
Liabilities, Surplus, and Other Funds
As of December 31, 2001

Aggregate reserve for accident and health policies	\$ 52,269,420
Policy and contract claims:	
Accident and health	57,396,636
Premiums and annuity considerations received in advance	197,453
Policy and contract liabilities not included elsewhere:	
Interest maintenance reserve	1,869,365
General expenses due or accrued	10,212,838
Taxes, licenses, and fees due or accrued, excluding federal income taxes	2,013
Amounts withheld or retained by company as agent or trustee	67,623
Miscellaneous liabilities:	
Asset valuation reserve	25,269,847
Payable to parent, subsidiaries and affiliates	28,934,158
Drafts outstanding	9,401,859
Payable for securities	<u>4,944,406</u>
Total Liabilities	190,565,618
Common capital stock	2,000,000
Unassigned funds (surplus)	<u>92,735,101</u>
Surplus	<u>94,735,101</u>
Total Liabilities, Surplus, and Other Funds	<u>\$285,300,719</u>

WEA Insurance Corporation
Summary of Operations
For the Year 2001

Premiums and annuity considerations for life and accident and health policies and contracts	\$525,706,196
Net investment income	9,624,217
Amortization of interest maintenance reserve	533,016
Write-ins for miscellaneous income:	
Miscellaneous Income	<u>319,829</u>
Total income items	536,183,258
Disability benefits and benefits under accident and health policies	525,508,018
Increase in aggregate reserve for life and accident and health policies and contracts	<u>9,100,820</u>
Subtotal	534,608,838
General insurance expenses	31,884,906
Insurance taxes, licenses, and fees excluding federal income taxes	1,286,575
Write-in for deductions:	
Loss on Sale of Assets	<u>17,940</u>
Total deductions	<u>567,798,259</u>
Net gain from operations before dividends to policyholders and federal income taxes	(31,615,001)
Dividends to policyholders	<u>0</u>
Net gain from operations after dividends to policyholders and before federal income taxes	(31,615,001)
Federal income taxes incurred (excluding tax on capital gains)	<u>0</u>
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses)	(31,615,001)
Net realized capital gains or (losses) less capital gains tax and amount transferred to the IMR	<u>9,208,291</u>
Net Loss	<u><u>\$(22,406,710)</u></u>

WEA Insurance Corporation
Cash Flow
As of December 31, 2001

Premiums and annuity considerations for life and accident and health policies and contracts	\$519,458,956	
Net investment income	9,436,872	
Write-ins for miscellaneous income:		
Miscellaneous Income	<u>319,829</u>	
Total		\$529,215,657
Disability benefits and benefits under accident and health policies	<u>524,058,833</u>	
Subtotal	524,058,833	
General insurance expenses	33,976,949	
Insurance taxes, licenses and fees, excluding federal income taxes	1,289,192	
Write-ins for deductions:		
Loss on Sale of Assets	<u>17,940</u>	
Subtotal	559,342,914	
Total deductions	<u>559,342,914</u>	
Net cash from operations		\$(30,127,257)
Proceeds from investments sold, matured, or repaid:		
Bonds	158,542,694	
Stocks	108,902,289	
Miscellaneous proceeds	<u>4,465,654</u>	
Total investment proceeds		271,910,637
Cost of investments acquired (long-term only):		
Bonds	157,491,732	
Stocks	87,202,233	
Miscellaneous applications	<u>7,590,641</u>	
Total investments acquired		<u>252,284,606</u>
Net cash from investments		19,626,031
Cash provided from financing and miscellaneous sources:		
Other cash provided	<u>10,208,130</u>	
Total		10,208,130
Cash applied for financing and miscellaneous uses:		
Other applications	<u>1,222,884</u>	
Total		<u>1,222,884</u>
Net cash from financing and miscellaneous sources		<u>8,985,246</u>
Net change in cash and short-term investments		\$(1,515,980)
Reconciliation		
Cash and short-term investments, December 31, 2000		<u>15,811,089</u>
Cash and short-term investments, December 31, 2001		<u>\$14,295,109</u>

WEA Insurance Corporation
Compulsory and Security Surplus Calculation
December 31, 2001

Assets		\$285,300,719	
Less Common Stock Adjustment*		11,674,271	
Less liabilities		<u>190,565,618</u>	
Adjusted surplus			\$83,060,830
Annual premium:			
Group life and health	519,458,956		
Factor	<u>10%</u>		
Total		<u>\$51,945,896</u>	
Compulsory surplus (subject to a \$2,000,000 minimum)			<u>51,945,896</u>
Compulsory surplus excess or (deficit)			<u>\$31,114,934</u>
Adjusted surplus			\$83,060,830
Security surplus:			
(140% of compulsory surplus, factor reduced 1% for			
each \$33 million in premium written in excess of			
\$10 million with a minimum of 110%)			<u>64,932,370</u>
Security surplus excess or (deficit)			<u>\$18,128,460</u>

* Under s. 620, Wis. Stats., WEAIC's investment in common stock is limited to 20% of assets for the purpose of calculating compulsory and security surplus. The calculation also allows for a 5% "basket" to include investments exceeding the class and individual limits, so that a total common stock investment of 25% of assets can be counted toward compulsory and security surplus. For the purpose of this calculation, WEAIC must reduce assets by the amount of common stock exceeding 25% of assets; however, the company is still above the required levels after the reduction is made.

WEA Insurance Corporation
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2001

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999	2000	2001
Capital and surplus, beginning of year	\$117,024,253	\$126,319,615	\$151,025,247	\$156,985,839	\$127,805,452
Net income	7,034,964	10,774,273	(4,354,530)	(10,198,082)	(22,406,710)
Change in net unrealized capital gains or (losses)	19,642,284	22,755,202	19,001,182	(21,040,507)	(19,211,744)
Change in non-admitted assets and related items	(292,348)	(630,147)	(1,871,388)	(322,540)	(978,676)
Change in asset valuation reserve	(7,689,538)	(8,193,696)	(6,814,672)	6,880,742	9,526,779
Capital changes:					
Paid in	(9,400,000)			(4,500,000)	
Capital and surplus, end of year	<u>\$126,319,615</u>	<u>\$151,025,247</u>	<u>\$156,985,839</u>	<u>\$127,805,452</u>	<u>\$94,735,101</u>

In 1997, WEAIC remitted \$9,400,000 to WEAIT and recorded the transaction as a return of paid-in surplus. In 2000, WEAIC remitted an additional \$4,500,000 to WEAIT. Both transfers were made with the prior approval of the Office of the Commissioner of Insurance under the extraordinary dividend law.

WEA Insurance Corporation
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2001

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

	Ratio	1997	1998	1999	2000	2001
#1	Net change in capital & surplus	16%	20%	4%	-16%*	-26%*
#2	Gross change capital & surplus	8	20	4	-19*	-26*
#3	Net income to total income	2	3	-1*	-2*	-4*
#4	Comm and Exp to Prem and Deposits	Discontinued				
#5	Adequacy of investment income	999*	999*	999*	0NR	0NR
#6	Non-admitted to admitted assets	1	1	1	1	2
#7	Total real estate & mortgage loans to cash & invested assets	0	0	0	0	0
#8	Total affl investments to capital & surplus	0	0	0	0	0
#9	Surplus relief	0	0	0	0	0
#10	Change in premium	12	13	13	18	20
#11	Change in product mix	0	0	0	0	0
#12	Change in asset mix	2	1	1	1	1.1
#13	Change in reserving ratio	0	0	0	0	0

Both ratios 1 and 2 calculate the change in the company's capital and surplus from the prior year. Ratio 1 calculates the change net of any paid-in capital; ratio 2 calculates gross of paid-in capital. A result below -10 is considered exceptional. In 2000 and 2001, the company had losses from operations, due to increased benefits paid and to reserve increases reflecting the expanding number of policyholders served, especially in long-term care. The company also had increases in unrealized capital losses, due to the declining value of its common stock portfolio. These items combined to produce significant decreases in the company's surplus in both years. The two ratios are different for 2000 because the company returned \$4,500,000 of paid-in capital to its parent trust in that year, decreasing surplus further. This return is reflected in ratio 2 but not in ratio 1.

Ratio 3 calculates the ratio of net income to total income (a figure that includes total premium and investment income, as well as realized capital gains). A negative result is considered exceptional. The company's exceptional results in 1999, 2000 and 2001 were due to the net loss for these years, indicating that the company's benefit payments, operating expenses and reserve increases have outpaced its income. The downward trend of the ratio indicates that the discrepancy between income and expenses is increasing.

Ratio 5 indicates whether the company's investment income is adequate to meet the interest requirements of its reserves. A result above 900 or below 125 is considered exceptional. The company's result of 999 for 1997, 1998 and 1999 is considered "exceptional;" however, the company has no interest requirements related to its reserves, and 999 is the automatic result when interest requirements are zero. The exceptional result is not an indication of insufficient reserves. The company is a group health insurer; as the company's business is not written on a level premium basis, there are no tabular reserves, so this ratio is not meaningful under the company's current mix of business.

Growth of WEA Insurance Corporation

Year	Admitted Assets	Liabilities	Surplus
1997	\$246,550,622	\$120,231,007	\$126,319,615
1998	287,246,553	136,221,306	151,025,247
1999	310,319,785	153,333,946	156,985,839
2000	303,599,468	175,794,016	127,805,452
2001	285,300,719	190,565,618	94,735,101

Accident and Health

Year	Net Premiums Earned	Net Losses Incurred	Commissions Incurred	Other Expenses Incurred	Combined Loss and Expense Ratio
1997	\$289,995,018	\$272,813,582	\$0	\$20,499,353	101.1%
1998	326,339,797	305,382,063	0	22,674,653	100.5
1999	368,306,185	359,488,372	0	26,106,671	104.7
2000	434,273,921	433,760,028	0	30,574,314	106.9
2001	525,706,196	532,442,661	0	33,171,481	107.6

The company's admitted assets have decreased since 1999 due to decreases in the value of common stocks, reflective of an overall decline in the market in these years. Surplus decreased due to both poor operating results and the unrealized capital losses on common stocks. In 2002, the company did re-evaluate its distribution of invested assets and decreased the amount invested in common stocks.

The company's premiums written increased as the number of participating school districts increased, and as existing participants revised their plans to include the company's dental, prescription drug, disability and long-term care coverages. However, incurred losses and other expenses also increased; in 1999, expenses began to exceed revenues, and the gap has increased each year. The company is addressing the gap with a variety of strategic measures, including rate increases to bring premiums above projected claim costs; revisions to provider networks; and changes in benefit plan structures to increase cost effectiveness.

Reconciliation of Surplus per Examination

There were no adjustments to surplus as a result of the examination. The following reclassifications were made as a result of the examination:

	Debit	Credit
Receivable from Parent, Subs and Affiliates	\$ 427,164	
Payable to Parent, Subs and Affiliates		\$ 427,164
Payable to Parent, Subsidiaries and Affiliates	29,000,000	
Premium Received in Advance		29,000,000
Cash and Short-Term Investments	7,590,641	
Receivable for Securities	<u>7,590,641</u>	<u>7,590,641</u>
Total reclassifications	<u>\$37,017,805</u>	<u>\$37,017,805</u>

Further discussion of these reclassifications is included in the section of this report entitled "Summary of Current Examination Results."

VI. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were ten specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. IT Environment—It is recommended that IT employees be included under the company's fidelity bond.

Action—Compliance.

2. IT Environment—It is recommended that the company establish a control where all system logs are reviewed on a regular basis.

Action—Partial compliance, see comments in the summary of current examination results.

3. IT Environment—It is recommended that the company's internal audit function include testing to ensure that system controls are operating as expected. This could include the periodic review of system logs.

Action—Compliance.

4. Invested Assets—It is recommended that in Schedule D of future annual statements, the company denote investments for which it has reported a company-assigned designation with a "z."

Action—Compliance.

5. Invested Assets—It is suggested that the company maintain current, executed copies of the investment management agreements.

Action—Compliance.

6. Invested Assets—It is recommended that the custodial agreement with Firststar Bank be amended such that:

- a) The company's securities shall be held separate and apart from other deposits held by the custodian so that at all times they may be identified as belonging to WEAIC.
- b) In the event of a loss of securities for which the custodian is obligated to indemnify WEAIC, the securities and the value of any loss of rights or privileges resulting from the loss of securities shall be promptly replaced.

Action—Compliance.

7. Common Stocks—It is recommended that in future annual statement filings, the company adjust the compulsory and security surplus calculation to reflect the investment limits imposed by ch. 620, Wis. Stat.

Action—Compliance.

8. Short-Term Investments—It is recommended that in future annual statements the company properly classify money market mutual funds per the requirements of the NAIC Annual Statement Instructions – Life, Accident and Health.

Action—Compliance.

9. Accident and Health Premiums Due and Unpaid—It is recommended that in future annual statements, the company non-admit premiums receivable that are more than 90 days past due.

Action—Compliance.

10. General Expenses Due or Accrued—It is recommended that the company report its obligation for payments under purchase lease term notes as a write-in liability in future annual statements.

Action—This recommendation is no longer applicable. The company has no current obligations under this type of note.

Summary of Current Examination Results

IT Environment

WEAIC's control environment appears to adequately secure the company's data. However, some areas of concern were encountered.

The company currently uses a "three strikes" provision to identify and revoke logon ID's on which three successive invalid attempts have been made. However, the current system accumulates invalid attempts only between valid attempts. Persons who may attempt to "crack" a logon password may well be aware of a three strikes provision, and limit attempts to two, between valid logons, providing an extended opportunity to crack a password. Without periodic review of logon failures by management, this pattern may never be noticed. It is recommended that the company develop procedures to ensure that critical events, such as invalid logon attempts, within the AS/400 production environment are reviewed on a timely basis.

The company does not review program modifications to ensure that only authorized program changes are being made. The company believes that such review would be a burden on supervisory and management staff that cannot be afforded at present; rather, the company relies on other programmers to catch "mischievous code" or code that does not function as required. However, this control may be effective only after the fact, if at all. Other programmers may not have or take the time to review another's work; and the effects of any mischievous changes may not be immediately noticeable. It is recommended that the company review all modifications to ensure that only authorized program changes are being made.

During review of the cash disbursements process, examiners noted that IT operators had the ability to edit the payee and the check amount for checks that were printed or transferred to magnetic tape on the AS400. The AS400 keeps a log of fields that have been edited and the terminals used to make the edits. The report is printed and reviewed only by an IT operator who also has edit capabilities. The log is purged from the AS400 when printed; the printed copy is kept for six months and then destroyed. With the insurer's current cash disbursements process, an IT operator has the ability to make an unauthorized disbursement by editing the payee or the amount of a previously authorized disbursement, and such edits would not be detected by

controls currently in place. It is recommended that a periodic review of the AS400 disbursement edit log be performed by an employee who does not have the ability to edit disbursements.

Receivable for Securities

Examiners discussed the receivable for securities with company personnel and a representative of the investment manager, and determined that the transaction is a repurchase agreement which settled on the next business day. The agreement is renewed daily at the close of business, and settled on the following business day. The continual renewal is due to a restriction on the amount of cash that can be held in the account.

Per SSAP 45, the repurchase agreement should be considered a collateralized loan. The underlying security that is received as collateral should be reported as a short-term investment. This balance will be reclassified from Receivable for Securities to Cash and Short-Term Investments. SSAP 45 also lists the related disclosures required for repurchase agreements; the company made no such disclosures in the 2001 annual statement. It is recommended that the company follow the guidelines of SSAP 45 with regard to the proper reporting of repurchase agreements, and that the company make appropriate disclosures in the notes to the financial statements as required by SSAP 45.

Payable to Parent, Subsidiaries and Affiliates

The company's affiliate, WEA Insurance Trust, performs billing functions for WEAIC, and collects all premium receipts according to the terms of an operating agreement between the parties. The agreement requires two transfers of the premium receipts, one on the twenty-fifth of the month of collection, and a final settlement on the tenth of the following month. As WEAIC bills a month ahead, cash receipts in December 2001 are for policies effective in January 2002.

WEAIC accounts for transfers under the agreement as a "payable to affiliates" if received prior to the effective month. However, these funds meet the definition of "advance premium" as noted in SSAP 54, and as such should be reported as premiums received in advance on WEAIC's financial statements. Classification as payable to affiliates does not appear appropriate, as the operating agreement notes that these transfers are premium receipts, and are not subject to repayment to WEA Insurance Trust. This balance will be reclassified from Payable

to Parent, Subsidiaries and Affiliates to Premium Received in Advance. It is recommended that the company classify transfers of premium from WEA Insurance Trust as premiums received in advance, if received prior to the effective date of the policies.

During the review of the premium receipts process, it was further noted that WEA Insurance Trust was not settling the balances by the tenth of the month following collection, as required by the operating agreement. In the months reviewed, examiners noted final settlement as late as the twenty-third of the month following collection. It is recommended that the company follow the terms of its operating agreement with regard to the settlement of balances.

The company previously received a permitted accounting practice from this office allowing them to net all balances receivable from and payable to all affiliates into one reported balance. Review of current guidance provided by Codification shows that this practice is no longer appropriate. SSAP 64 notes that assets and liabilities shall be offset and reported net only when a valid right of setoff exists. A valid right of setoff does not exist between a receivable from one affiliate and a payable to another affiliate. These balances must therefore be reported separately on the annual statement. This balance will be reclassified from Payable to Affiliates to Receivable from Affiliates. It is recommended that the company report affiliated balances in accordance with the provisions of SSAP 64.

Subsequent Event

Following an investigation, OCI issued a Cease and Desist Order, dated April 3, 2001 and amended June 4, 2001, directing WEAIC to cease and desist its practice of changing an insured's rating basis from pool to individual experience-based premium as a direct consequence of the insured requesting and receiving individual claim experience. OCI contended that this practice violated s. 632.797, Wis. Stat. WEAIC contested the order and requested a hearing before an Administrative Law Judge to determine whether the amended order should be upheld, modified or rescinded. The hearing was held September 24 and 25, and October 3, 2001. In a decision dated May 2, 2002, the Administrative Law Judge found that WEAIC's practice was in violation of s. 632.797, Wis. Stat., and concluded that OCI's amended Cease and Desist Order should be upheld.

On May 24, 2002, WEAIC exercised its right under s. 227.53, Wis. Stat., by filing a Petition for Review against OCI in Dane County Circuit Court. To date, the status of the suit is that WEAIC was granted a Motion for Stay of enforcement pending judicial review. A decision has not yet been rendered as to the merits of the case although briefing on the merits was concluded on or about November 29, 2002.

VII. CONCLUSION

The examination found that WEA Insurance Corporation had admitted assets of \$285,727,883; liabilities of \$190,992,782; and surplus of \$94,735,101 as of December 31, 2001.

Although claims and operating expenses have exceeded revenues for the past three years, the company is taking a number of steps to address the problem and to improve underwriting performance. The company is also making changes to its investment strategies to reduce the unrealized capital losses on common stocks. Surplus has decreased in 2000 and 2001, but the company appears focused on reversing this trend.

The company complied with nine of the ten prior examination recommendations, and partially complied with the tenth recommendation. The current examination resulted in seven recommendations and three reclassifications, with no adjustments to surplus.

VIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 22 - IT Environment—It is recommended that the company develop procedures to ensure that critical events, such as invalid logon attempts, within the AS/400 production environment are reviewed on a timely basis.
2. Page 22 - IT Environment—It is recommended that the company review all modifications to ensure that only authorized program changes are being made.
3. Page 23 - IT Environment—It is recommended that a periodic review of the AS400 disbursement edit log be performed by an employee who does not have the ability to edit disbursements.
4. Page 23 - Receivable for Securities—It is recommended that the company follow the guidelines of SSAP 45 with regard to the proper reporting of repurchase agreements, and that the company make appropriate disclosures in the notes to the financial statements as required by SSAP 45.
5. Page 24 - Payable to Parent, Subsidiaries and Affiliates—It is recommended that the company classify transfers of premium from WEA Insurance Trust as premiums received in advance, if received prior to the effective date of the policies.
6. Page 24 - Payable to Parent, Subsidiaries and Affiliates—It is recommended that the company follow the terms of its operating agreement with regard to the settlement of balances.
7. Page 24 - Payable to Parent, Subsidiaries and Affiliates—It is recommended that the company report affiliated balances in accordance with the provisions of SSAP 64.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
William C. Genne	Insurance Examiner
Russell L. Lamb	Insurance Examiner
Ryan J. Hanson	Insurance Examiner
Cruz J. Flores	Data Processing Specialist

Respectfully submitted,

Sarah M. Salmon, CPA
Examiner-in-Charge